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SUBJECT: FUEL PRICE INCREASES IN JORDAN ON THE HORIZON

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11. (U) SUMMARY: Royal Court Minister Marwan Muasher June 27 spoke briefly about lifting oil subsidies in remarks carried prominently in most of the Arabic-language dailies. It is only a matter of time before the first wave of oil and gas price hikes are announced and implemented. Muasher's remarks appear to be paving the way. As the Government of Jordan (GOJ) considers when to initiate the removal of subsidies on oil products, we review below the current GOJ price structure and proposed pricing methodology, and detail where the targets for subsidy removal (and price increases) are, and some of the likely effects. Refined diesel gas for vehicles and heating -- most produced at the Jordan Petroleum Refinery -- accounts for the largest share of subsidies. Increases in diesel prices will immediately affect commercial transportation. In resource-poor Jordan, where most goods including consumables are transported by truck, the price rise will contribute to inflation in the near-term. Residential heating, electricity generation and industries will also be hit, but the effects may not appear for some time. The significance of the impact will depend heavily on the percentage of hikes chosen across a range of products. END SUMMARY.

12. (SBU) Muasher was reviewing the wider national agenda when he commented on the GOJ budget strains and the need to address what one daily headlined as the "end of the oil subsidy era." He said that the budget deficit due to oil subsidies could prove "disastrous" and that the international rise in crude oil prices had to be dealt with by the GOJ. A separate article in daily Al Rai carried the government Spokesperson's statement that the cabinet had discussed the possibility of raising the price of fuel in Jordan. The same article cited unnamed informed sources stating that the cabinet had established a committee headed by the Minister of Energy to discuss alternatives to oil subsidies under different scenarios. (COMMENT: It appears that these remarks were intended to lay the groundwork for an official announcement regarding oil product price hikes sometime in the near future, most likely after the new government is sworn in and members of parliament give their public backing to it. In fact, the cabinet has already decided to eliminate the subsidies over a three-year period, starting with a 25 percent cut next month. END COMMENT.)

Diesel a Potential Big Target  
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13. (SBU) According to the Ministry of Energy (MOE), subsidies applied to diesel account for \$350 million of the \$550 million now allotted to oil subsidies under the revised budget (this and all other figures in this message are based on a crude oil price of \$45 per barrel, "the current market price"). Diesel is currently priced at 0.135 Jordanian Dinars (JD) per liter, whereas the MOE calculates the price would be 0.300 JD/liter at the current market price with no subsidy. (The exchange rate has been stable at \$1.41/1 JD.) Last year, Jordanians consumed 1.75 million tons of diesel,

the largest share among eight major oil product categories. The first of three diesel price hikes over the next 18 months is likely to appear to be a "high percentage" according to an MOE source, but only because the 0.135 JD base is so low compared to the target 0.300 JD. (NOTE: If the price rose about 32 percent in each of three increases, it would reach the new 0.300 JD benchmark. A first price hike in the 20-32 percent range would be mathematically feasible, while still allowing for balanced, nearly equivalent subsequent increases, and spreading out the effects. END NOTE.)

14. (SBU) Fuel oil used by industries and to generate electricity represents the second largest share of consumption in Jordan, at 1.43 million tons in 2004. MOE analysts say that fuel oil should not undergo as large an increase, compared to diesel, because it has not been as heavily subsidized.

15. (SBU) If diesel prices are raised, the added costs to Jordan's extensive commercial transportation industry (Transportation and Communications represent 19 percent of GDP) would be felt by the average citizen. Jordan has few natural resources and imports a wide range of consumables and raw inputs for manufacturing. Transporting some \$8.1 billion in imports (73 percent of GDP) to population and manufacturing centers in the north from distant Aqaba in the south will contribute to a rise in domestic prices as costs are passed to consumers in the near term. When consumers purchase heating oil later this year, they will again directly see the impact of the fuel increases on their lives.

16. (SBU) Similarly, the cost of generating electricity and industrial production would go up. Those plants fired by fuel oil may not see such a dramatic impact as those running on diesel (see para 4). However, how and when those costs are passed to the consumer would vary more widely than the transportation-based and heating oil increases.

#### Aviation Fuel A Pass-Through?

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17. (SBU) Jet fuel has a two tiered price scheme in Jordan. Local companies (read Royal Jordanian) are now charged 0.190 JD per liter while all others are charged 0.290 JD/liter. MOE sources say that these would be brought up to the current market price (and to parity) in just two steps. The percentage increase in "local company" jet fuel prices would obviously be higher. Tour agency operators in Jordan familiar with the pending adjustment have been warning customers that already-purchased RJ tickets may see a fuel-price-increase fee slapped on when the jet fuel price hikes are implemented. (Post is faxing to NEA/ELA and EB/ENR the current GOJ petroleum price list.)

#### Pricing Basis May be Stabilizing

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18. (SBU) Also under review by the GOJ is the basis for oil product pricing. The pricing methodology being favored, according to informed MOE sources, is the "import parity" basis. That is, the oil product pricing would be based on the world crude oil prices (as given for an Aqaba port delivery) plus tariffs, handling costs, and transport to the point of sale. For example, if the price of diesel at the pump near the Zarqa JO Petrol oil refinery is the baseline, then the price of refined diesel transported to southern Ma'an would be higher. This policy would remove another hidden cost of fixing the price of fuels nationwide.

19. (SBU) COMMENT: We understand that GOJ policy makers are reviewing extensive impact reports based on a wide range of fuel price increase scenarios. While the "mix" of increases across eight fuel categories that the GOJ finally chooses may give some leeway in determining how and when the public feels the effects, Minister Muasher's comment remains central to the policy question: the Jordanian public must be prepared to deal with the new subsidy-free era. The GOJ is now embarking on its effort to inform the public and shape the

reaction while maintaining fiscal integrity. With world crude prices hitting record levels, members of the Jordanian public will have to learn to accept the simple economic facts of life -- they must pay for their oil as they consume it. It remains to be seen how ready they are and how much they can accept.

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